

THE IMPACT OF THE TAX REFORM ACT OF 1986 ON THE
BLACK POPULATION WITH PARTICULAR REFERENCE
TO THE INDIVIDUAL INCOME TAX

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ABSTRACT
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The Impact of the Tax Reform Act of 1986 on The Black Population With
Particular Reference to the Individual Income Tax

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The primary intent of this degree paper is to discuss some of the probable impact of the Tax Reform Act of 1986 on Blacks. An attempt has been made to show the economic status of the Black population and to explain the probable impact of the Tax Reform Act of 1986 on it.

The old tax system had several shortcomings which prompted the need for tax reform. Among the several reasons for a new tax system were lack of efficiency and equity in the old system. Black politicians advocated more support for the equity side due to the disproportional distribution of the Black population, the distribution of income (majority of Black incomes are found in the lower income brackets and only about 20 percent of their income comes from property while majority of it comes from employment). Also, proportionally, more Black female head of households are found in that category (head of household) than White females. These circumstances would put the Black population in a position to bear more of the tax burden proportionally, than the White population.

The major findings of the study were that (1) the restructuring of the tax rates could lower the progressivity of the tax system (this could probably have a

disproportional adverse impact on the Black population), and (2) that the increase in the standard deduction and personal exemptions would probably compensate for this adverse impact on Blacks and other minority groups.

It was concluded that the impact of the overall tax system on the tax burdens of the Black population, depends on the extent to which the system stresses progressive versus regressive taxes. There is still room for improvement and reform, and that through more research, income tax reforms can be made better.

The main sources of information for this paper include The Atlanta Journal and Constitution, Consumer Reports, National Tax Journal, publications from the Bureau of the Census, and the Internal Revenue Service. Also, a wide variety of primary and secondary information was used.

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I. INTRODUCTION AND OVERVIEW

The pre-eminence of the individual income tax in the federal revenue system reflects its productivity and, more basically a widespread belief that it is the fairest means of meeting national government costs. Moreover, as the federal government has assumed greater responsibility for moderating economic fluctuations, the quick response of the income tax to changes in business activity has come to be considered a valuable stabilizing force as well as a fiscal convenience.

Opinions about the income tax, however, are sharply divided. Public opinion polls taken in 1972, 1973, and 1974 found that the federal income tax was regarded as the fairest of the major taxes used by the federal, state and local governments but that it was considered the least fair by a large and growing minority of respondents.¹ Another poll, taken in mid-1973, found that 52 percent of respondents believed that the income tax was the fairest way of raising federal revenue but that 28 percent thought that a sales tax would be fairest.²

Criticisms of the income tax have persisted throughout its history. These criticisms differ in sophistication and vehemence and are advanced from various points of view. Some of the objections reflect simple dissatisfaction with heavy taxation of any kind and concentrate on reduction of tax rates. This dissatisfaction has been aggravated at times by the increases in income tax liabilities that

¹Richard Goode, The Individual Income Tax (Washington, D.C.: The Brookings Institution, 1976), p. 10.

²Gregg Harris, "Nationwide Cross Section of 1,537 Households," The Washington Post, 24 July 1973, p. 5.

automatically accompany rising incomes, whether as a result of real growth or inflation. Many critics, however, believe the income tax is more objectionable than alternative taxes and should be partly or wholly replaced.

An income tax with high, graduated rates is said to inhibit private savings and investment and thus slow capital formation and the rate of economic growth. It is also said to discourage initiative and enterprise in business ventures and to lessen the willingness to accept new and more responsible employment or to work long hours. Moreover, the income tax is alleged to cause business executives and individual investors to divert time and ingenuity from productive activities to tax compliance and tax liabilities minimization.³ Efforts to avoid taxation are thought to reduce economic efficiency because they distort decisions about forms of business organizations, contracts, and portfolios.

Many supporters of the income tax have become less enthusiastic. They are disturbed by special provisions allowing much income to escape taxation, the ingenuity of taxpayers in finding loopholes, the reluctance of Congress to repair the erosion of the tax base, and the incomplete compliance with law. In 1970, for example, the amount of income actually taxed equalled only about one half of total personal income.⁴ Some economists have concluded that the income tax is less neutral in its effects than was often supposed in the past, and egalitarians ask whether or not progressive taxation of income is the best means of attaining their objectives. Suggestions for new forms of taxation have received far more attention from experts recently than they did thirty years ago.⁵

³Ibid., p. 44.

⁴Goode, The Individual Income Tax, p. 40.

⁵Ibid., p. 43.

Suggestions for improvement were numerous and varied. They called for minor technical amendments to abolition of the tax. A favorite program among supporters of the income tax includes broadening the base by ending unjustified omissions and deductions from taxable income and reducing nominally high tax rates to offset the revenue gained from base-broadening. As originally conceived, this approach was designed to maintain, or enhance, the role of the income tax in the federal revenue system.⁶

Recently, several proposals to reform the tax system came before the Congress. The most widely discussed proposals were those of the Reagan Administration, the Bradley/Gephardt, and the Kemp/Kasten proposals. Others include, the House bill, the Senate amendment bill and finally the Conference agreement. The Conference agreement which is referred to as the Tax Reform Act of 1986, was signed into law by President Reagan on October 22, 1986. The Federal Government collects taxes in order to provide public goods and services. Therefore, a tax reform which is primarily intended to cut taxes for the community at large including Blacks, is also necessary to improve on the former tax system by increasing its efficiency and equity in general.

Apparently, the former tax system was too complex, too unfair and too inefficient. Revenues leaked through the loopholes in the tax code and confidence in the tax system itself drained out. In the former tax system, professional help was needed to file for the tax returns. Moreover, it was unfair to the average person who believes that the middle and upper income people paid too little.

The system was designed to be progressive - that is, the rates paid by those with higher incomes are higher than those paid by taxpayers with lower incomes.

⁶Ibid., p. 45.

The assumption is that those who earn more can afford to pay a higher portion of their income in taxes. It was inefficient because the escape hatches that the Congress put in the tax code to further certain activities such as savings and investment did not always work as intended. For example, some banks have reported that they did not see any obvious increase in savings accounts as a result of lower tax rates.⁷

The Southern Center discussed the most cited goals for tax reform thus:

The most generally cited goals for tax reform are to increase equity and to increase efficiency. The reformers as well as the Congress proclaim these objectives as their goals. These objectives are also goals for the Black population. The Black politicians focus specially more on equity aspects rather than on efficiency concerns. However, this does not mean that there should be special consideration for Black taxpayers. Apparently, tax reform that increases its equity in general automatically increases equity and fairness for the Black taxpayers. This is because the extra burdens imposed on Blacks by an unfair tax system derive primarily from the fact that the unusual biases have a disproportionate impact on Blacks rather than from the fact that there are special provisions or policies which are disadvantaging Black taxpayers.

They went further to explain the equity side of the system thus:

In general knowledge, tax equity is discussed in terms of ability to pay principle which defines vertical equity. Under this principle, tax liability is allocated to individual taxpayer in accordance with the taxpayers relative ability to pay. The people that earn greater income are expected to a higher tax liability than those people with relatively lower incomes. Equity could also be defined apart from ability to pay, that is vertical equity. It could be defined horizontally. Horizontal equity states the equal treatment of equals principle.

⁷"Investment and Savings," The Atlanta Journal and Constitution, 12 January 1985, p. 7B.

⁸Southern Center for Studies in Public Policy, Clark College, "Racial Implications of Proposals to Reform the Personal Income Tax" (Atlanta, Georgia, November 1985), p. 2.

⁹Ibid.

Thus, irrespective of who the taxpayer is, whether Black or White, as long as both of them receive the same income, they should have the same tax obligations. It is assumed that a tax system that features both vertical and horizontal equity is fair and equitable, and would yield an appropriate racial distribution of the tax burden.

Apart from the disproportional distribution of the Black population, proportionally, more Blacks are found in the low-income brackets, more Black females are found in the head of household category (this means that proportionally, Black females would bear more of the tax burden than White females). Also 80 percent of Black income comes from employment while 20 percent of Blacks receive income from property. About 75 percent of White income comes from employment while 60 percent of Whites receive income from property (this means that more Whites would benefit from the several reliefs that property owners enjoy than Blacks because less Blacks receive income from property). The purpose of this study therefore, is to examine the probable impact of the individual income tax act of 1986 on the Black population.

II. THE PROBLEM AND ITS SETTING

Background of the Agency

The writer was an intern at the Southern Center for Studies in Public Policy (SCSPP). The Center is a research unit of Clark College, a historically Black College and one of the six institutions forming the Atlanta University Center. SCSPP was founded in 1968. It has, therefore, been in existence for eighteen years. It has focused on a variety of regional and national public policy issues. In 1980, the Policy Center sharpened its focus to concentrate on national policy issues relevant to the economic problem of Blacks and other minorities.

The goal of the Policy Center research program is to seek ways to improve the relative economic positions of Blacks and minorities through the conduct of objective and non-partisan research. Further, the research program is designed to create the knowledge required to develop more effective strategies, policies and programs to aid in improving the relative economic position of these groups.

Over the last ten years, the Center has conducted over fifty studies including evaluation, policy analysis, and other related research. The Center has also conducted a number of research projects specifically related to poverty and employment problems. It recently conducted a study on racial implications of proposals to reform the personal income tax. Many SCSPP projects have had broad implications for both the development and implementation of policies. The Center has five major research areas. They are:

- o Labor Market Studies:- that focus on analyzing specific labor market problems and their causes (such as, employment, occupational status and distribution and structural problems) on individual and families and the types of policies required for remedy.

- o Income Studies:- that focus on analyses of income inequalities and seek strategies and policies to reduce these inequalities.
- o Welfare and Transfer Studies:- that focus on ways to reduce dependency on Income Maintenance and transfer payments among the able bodied population without increasing poverty.
- o Business Development and Property Ownership Studies:- that focus on analyses of economic development efforts and ways to increase business and property ownership.
- o Special Research Studies:- that focus on pertinent issues directly related to the economic research program and the overall mission of the Policy Center.¹⁰

Duties and Responsibilities of the Intern

The writer was engaged as a research assistant throughout the internship period. The major project of study was on the impact of the Federal Tax Reform Act of 1986 on the Black population. Other secondary duties like newsclippings of recent national economic problems were engaged in. The objective was to gain considerable knowledge of controversial matters in the country. Newsclippings were the best ways of collecting data on public views regarding economic issues. Through these, the writer was able to collect relevant information about tax reform. The writer also assisted in another major project titled, "The Effects of U.S. Trade Policy on Black Employment," which was supervised by Dr. Peter Jackson.

Conducting this research also provided more knowledge about the tax system and the trade policy of the United States. This experience also afforded the opportunity of working and consulting with the Director of the Center, Dr. David

¹⁰Southern Center for Studies in Public Policy, Clark College, Brochure 1986.

Swinton and also with Dr. Barbara Jones of the economics department of Clark College. Also of assistance were Miss Sharon Whipple and Miss Sharon Jackson. Some documents were easily made available to the writer because the Policy Center already had a paper written on a related subject matter.

Statement of the Problem

The primary intent of this paper is to discuss some of the probable impacts of the Tax Reform Act of 1986 on Blacks, with particular reference to the Individual Income Tax. Very few studies have used race as an explicit factor in any of the analyses that have examined the distributional effects of the tax reform proposals. It is important to consider this factor. A study found that Black households are 300 percent more likely to be below the poverty line than White households. Blacks are 225 percent more likely to be unemployed than Whites. The medium household income for Blacks is 59 percent that of Whites.¹¹

This study did not attempt to conduct a quantitative analysis of the impact of the tax law, but it sets out to use some underlying assumptions to discuss the probable impact of the law on the Black population. It is assumed (1) that since the majority of Black incomes come from employment, a tax system that favors property income over employment would shift the burden more towards Blacks, (2) that since Black distribution of income is found to be skewed towards the lower income classes, Blacks are harmed by a shift of the tax system to more regressive forms of taxation, (3) and that shifts from corporate sources to individual sources would disadvantage Blacks because more of their incomes come from employment.

¹¹ John Karl Scholz, "The Racial Implications of the 1981 Tax Act," prepared for the Leadership conference on Civil Rights, 1982, p. 1.

Considering these circumstances of the Black population, it is instructive to examine the impact of the individual income Tax Act of 1986 on the Black population.

III. REVIEW OF RELEVANT LITERATURE

The following literature review highlights some of the studies that have been conducted on the U.S. tax system and the tax reform act of 1986.

According to Joseph A. Pechman,¹² the tax system became less progressive between 1966 and 1985 primarily because the corporation income tax and the property tax declined in importance while more emphasis was placed on the payroll tax. The Flat tax as indicated by Consumer Reports sparked a flurry of interest a few years ago, partly because of its simplicity. But simplicity does not always bring equity. Flat taxes generally increase the tax liabilities for lower and middle-income taxpayers and reduce them for those with highest income. Consumer Reports pointed out that some estimates indicated that flat taxes would reduce the liabilities of upper-income taxpayers by some 30 to 40 percent.¹³

Consumer Reports also gave fictional cases that showed the implications of a flat tax (or tax simplification). It indicated that a single taxpayer with no mortgage to pay will win big. A family with dependants will break even and a couple with a gross income of \$120,000 (including stocks and sale of home) will probably lose out.¹⁴

John L. Mikesell explained the flat tax more. He pointed out that a tax levied for revenue is worthwhile only if it can produce reasonable revenue at

¹²Joseph A. Pechman, Who Paid the Taxes: 1966-1985? (Washington, D.C.: The Brookings Institution, 1985), p. 10.

¹³"What Will Happen to Your Taxes?" Consumer Reports 50 (January 1985): 16.

¹⁴*Ibid.*, p. 19.

socially acceptable rates.¹⁵ Since some taxes are levied either to encourage or discourage certain activities, revenue is still the major objective of most taxes. He went on further to indicate the adequacy of taxing unit by using an analytic device called the Laffer curve. This curve, he explains, relates to revenue collected from a specific tax base (for example, income) and tax rates applied to that base. The curve shows that a given amount of revenue can be collected at two rates, one high and one low. Thus, no revenue will be collected from a particular tax base if no tax is applied to that base or if a rate is applied which is so high that the taxed activity ceases to exist (for example, if a particular business is taxed highly, it will either drive people from getting into that business or drive the owners of such a business out of it).¹⁶

Mary Bourdette and Jim Weill, indicated that one of the old system's glaring inequities is the increasing burden on those least able to pay, those individuals and families who live in poverty or close to the poverty line. This indicates that families make up a large proportion of the poverty population. Nearly half (48.2) percent female headed families with children were poor in 1982, and the majority of children living in poverty in this country are part of female headed families.¹⁷

A study also indicated that Blacks as a group will face more severe benefit reduction than Whites. This is a consequence of the relative distributions of Black and White income. It further indicated that even when one controls for income, Blacks may face larger benefit reductions than Whites because of the age

¹⁵ John L. Mikesell, Fiscal Administration: Analysis and Applications for the Public Sector (Homewood: The Dorsey Press, 1982), p. 165.

¹⁶ Ibid.

¹⁷ Mary Bourdette and Jim Weill, "The Impact of Federal Taxes on Poor Families" (Washington, D.C.: Children Defense Fund, 1985), p. 3.

distribution of the poor (because proportionally, in the sixty five and over age category, there are more Blacks than Whites). Poor Blacks are more likely to be recipient of benefit payments than poor Whites.¹⁸

Expansion of the tax base similarly moves toward more equal taxation of all income, regardless of source.¹⁹ Hettich and Winer, pointed out a statement made by the Royal Commission on Taxation (Canada, 1966), that, they are completely persuaded that taxes should be allocated according to the change in economic power of individuals and families.²⁰

Those in support of equity, say that an equitable tax system recognizes that to those who have been given the most, there is a corresponding greater responsibility in bearing the burdens of self government. They further said that, equity also means people should avoid striving to "soak the rich" and instead treat income from all sources in the same manner.²¹ Independent of the question of the public becoming more familiar with major changes in the tax laws, says McCohany, is the possibility that some groups of taxpayers will experience serious economic problems not long after the change is enacted.²²

The rich people, as indicated in an article in the Progressive, obviously would

¹⁸Scholz, "The Racial Implications of the 1981 Tax Act," p. 1.

¹⁹Eugene C. Steuerle, "The Prospects for Tax Reform," National Tax Journal, vol. XXXVIII, no. 3 (September 1986): 293.

²⁰Walter Hettich and Starby Winer, "Blueprints and Pathways: The Shifting Foundation of Tax Reform," National Tax Journal, vol. XXXVIII, no. 5 (November 1985): 424.

²¹Senator Mark O. Hartfield, "Tax Reform: It's Time to Fulfill the Promise," Tax Notes (January 30, 1984), p. 2.

²²Mark McCohany, "A Long View of Tax Reform," National Tax Journal, vol. XXXIX, no. 3 (September 1986), p. 267.

pay less tax as the top declines drastically from 50 percent to 28 percent under the new law.²³ This article further indicated that this is a process of gradual abandonment of the concept of progressive, or graduated, income taxation.²⁴

A couple, when interviewed by U.S. News, said that although they want to rid the tax code of loopholes, they are willing to give up the deduction now allowed for consumer interest because he and his wife are trying to kick the credit-card habit. But they oppose any deletion of the deduction for state sales taxes, claiming that would amount to double taxation. Another interviewee,²⁵ disagrees on the Individual Retirement Accounts (IRA) issue (see next section). This interviewee (single), claimed that IRAs are for the rich people.²⁶

In the same interview, a person claims he likes the part that below a certain level, some people do not have to pay taxes.²⁷ Another interviewee also said that she would like more equity in the law, while someone else said he would be happy with lower rates as opposed to keeping all the deductions.²⁸ "As it stands", said another man, "the middle class takes the brunt of the tax burden, and some wealthy people and others get away with murder!"²⁹

A special report of Business Week, indicated that individuals and corporations

²³"Tax Retreat," Progressive, Vol. 50, 12 August 1986, p. 12.

²⁴Ibid.

²⁵"Taxpayers View of Tax Reform," U.S. News and World Report, 25 August 1985, p. 17.

²⁶Ibid.

²⁷Ibid.

²⁸Ibid.

²⁹Ibid.

will be able to keep more of the proceeds of smart investments and on the other hand, individuals too, will have to rethink a host of economic decisions, from owning a home versus renting, to setting up bank accounts for children to planning for retirement.³⁰

A newspaper article of 9-26-86, gave a report on a study of the new law, conducted by Synogetics Inc. It reported that the study predicted that most people with IRAs will continue to invest in them, auto purchases would be strong for the rest of 1986 to beat this years tax provision, credit-card customers will use the credit-cards less, credit-card interest rates will fall and lines of credit secured by home equity will become popular.³¹

A columnist in The Atlanta Constitution, criticized the new tax bill as not simple and not fair. He said that the bill immensely complicates a whole range of transactions for Americans in every group. He pointed out how it will be unfair to a machinist who has an heart attack and can no longer keep up the payments on the bungalow he bought for \$14,000 in 1963. If the machinist sells his house for \$10,000 and as if there had been no inflation, the entire dollar increase will now be taxed to him at the highest rate. Or is it fair to the barber who bought a few shares of General Motors stocks a couple of decades ago in an effort to build a modicum of personal financial security. When he sells, though his "gain" is largely inflation, the government will not tax it at ordinary rates.³² Thus, helping to

³⁰Howard Glaeckman, "Tax Reform at Last: A Special Report," Business Week, 1 September 1986, p. 55.

³¹Peter Mantius, "Tax Bill May Change Borrowing Practices," The Atlanta Constitution, 9 September 1986, p. 10B.

³²"Once Again, Now Tell us About the Tax Reform," The Atlanta Journal and Constitution, 15 September 1986, p. 6B.

assure that all his income that year will be taxed at the top rate.

Not much has been written on the impact of the tax bill on the Black population but a lot has been written on the law and on the middle income group and family structure in which the majority of the Black population falls under. However, from the above literature, it is reasonable to deduce that the Black population would probably lose out with respect to the rate structure, because the lowest rate is increased from 11 percent to 15 percent and the highest rate is reduced from 50 percent to 28 percent. This could probably hurt the Black population whose majority is in the lower bracket and favor the White population whose majority is in the higher income bracket. Blacks would be slightly compensated by the increase in the standard deduction, the personal exemptions and the earned income credit.

IV. SUMMARY OF THE INDIVIDUAL TAX ACT OF 1986

The Conference agreement which is now referred to as the tax reform act of 1986, was signed into Law by President Reagan on October 22, 1986. This law is the combination of both the House and the Senate proposals. Both Houses reached the agreement at a conference meeting.

According to the preliminary estimates by the Joint Tax Committee, the measure would provide an overall tax cut for individuals averaging 6.1 percent in 1988, compared to 8.6 percent under the House-passed bill and 7.0 percent under the Senate bill (see Table 1).

The conference agreement reduces and consolidates the old 15 tax brackets, ranging from 11 percent to 50 percent into just two - 15 percent, and 28 percent. For single taxpayers, the 15 percent rate applies to taxable income up to \$17,850, and the 28 percent rate applies to taxable income above this level. For joint returns the corresponding break point is \$29,750.

In terms of structure, the new law is somewhat similar to the Senate bill. The only difference is that the top rate is 28 percent instead of the 27 percent rate proposed by the Senate and the break points between the 15 percent and 28 percent rates are slightly higher than under the Senate bill. The new rates would take effect at the beginning of 1988. For 1987, a separate rate structure that represents a blend of the old and new rates applies. These rates for 1987 are 11 percent, 15 percent, 28 percent, 35 percent and 38.5 percent. This restructuring of the tax rate would probably shift the tax burden to Blacks. The reason could be because a large proportion of the Black population belongs to the income group (low and middle income group) that the increase in the lower tax rate (that is, 11

percent to 15 percent) applies to.

The new law phases out the benefits of the 15 percent tax bracket for taxpayers at fairly high income levels. This phase-out is accomplished by taxing some income at higher rates - essentially applying a five percent surcharge - until the benefit of the 15 percent bracket has entirely been recovered. For single taxpayers, these higher rates or surcharges would apply to taxable incomes between \$43,140 and \$89,550, for couples filing jointly, they would apply to taxable incomes between \$71,900 and \$149,250.

The tax law increases the amount of income that is automatically tax exempt for all taxpayers. This amount was known as zero bracket amount in the old law. For single taxpayers, the standard deduction would be increased to \$3,000, for married couples filing jointly it would be increased to \$5,000, and for heads of Households it would rise to \$4,400. Personal exemptions for taxpayers are increased to \$2,000.

The law continues the indexation for inflation of the tax brackets, standard deduction, and personal exemption. The law repeals the extra personal exemption to which persons aged 65 and over and blind persons are presently entitled. The law also increases the earned income credit - a special provision designed to help offset social security taxes and employment - related expenses for the working poor. Eligibility for this credit is limited to taxpayers with dependent children and with income from employment. It also repeals the two-earner (marriage penalty), income averaging, the exclusion for up to \$100 in divided income (\$200 for joint returns).

The law repeals the present itemized deduction for state and local sales taxes, effective in 1987 but retains the deduction for state and local income and property taxes.

The law restricts the itemized deductions for interest costs. Deductions would no longer be allowed for interest on various types of consumer loans -auto loans; credit cards for example - or on most educational related loans. The law did not alter the already made provision for the charitable contributions deduction which ended at the end of 1986. The tax law raises the threshold for medical expenses to 7.5 percent of adjusted gross income (AGI).

The tax law consolidates virtually all of the past deductions for employee business expenses and other miscellaneous items, and permits a deduction to be taken only to the extent that the aggregate amount exceeds two percent of the taxpayer's adjusted gross income. It also repeals the political contribution credit, deductions for capital gains, and terminates the present deduction for Individual Retirement Accounts (IRAs) contributions for some middle to upper income taxpayers who are also covered by other pension plans.

Overall, the impact would probably be favorable to Blacks with respect to the increase in standard deduction and personal exemptions, but the restructuring of the tax rate has been noted to reduce progressivity which is a sign of unfairness to Blacks and the taxpayers in general. Table 2 shows a summary of the credits given to taxpayers in the Old, House, Senate and New tax bills.

TABLE 1

AVERAGE CHANGE IN TAX LIABILITY BY INCOME
GROUP IN 1988
(Percentage Distribution)

Income	House Bill	Senate Bill	New Law
Less than \$10,000	-64	-57	-66
\$10,000 - \$20,000	-23	-21	-22
\$20,000 - \$30,000	-09	-10	-10
\$30,000 - \$40,000	-09	-07	-08
\$40,000 - \$50,000	-08	-09	-09
\$50,000 - \$75,000	-07	-03	-02
\$75,000 - \$100,000	-05	-02	-01
\$100,000 - \$200,000	-06	-01	-02
\$200,000 and over	-05	-05	-02
Total	-09	-07	-06

Source: Democratic Study Group, Fact Sheet: Summary of Tax Agreement, U.S. House of Representatives, Representatives, Washington, D.C. 20515.

NOTE: These figures represent averages, within each income group some taxpayers will receive tax increases, while others will receive larger-than-average tax cuts.

TABLE 2

SUMMARY OF RECENT PROPOSALS

	Old Bill	House Bill	Senate Bill	Conference Agreement
Taxrates (percentage distribution)	11-50	15,25,35,38	15,27	15,28
Personal Exemptions				
Yourself/Spouse	\$1,040	\$2,000	\$2,000	\$2,000
Children and other dependants	1,040	2,000	2,000	2,000
Elderly and the Blind	1,040	0	0	0
Standard Deductions				
Single taxpayers	2,390	2,590	3,000	3,000
Married Couples	3,540	4,800	5,000	5,000
Head of Household	2,390	4,200	4,400	4,400
Earned Income Tax Credit	Yes ¹	Yes ²	Yes ³	Yes ⁴

Source: Congressional Research Services, Update, 113 85099, Washington, D.C., August 21, 1986, p. 2.

¹Under the Old law the earned income credits is 11 percent of the first \$5,000 of earned income for a maximum credit is first phased out of income levels above \$6,500 and is zero at income levels of \$11,000 and above.

²Under the House Bill the earned income credit is increased to 14 percent of the first \$5,000. The income at which the credit is completely phased out is raised to \$13,500; effective for taxable years beginning on or after January 1, 1986.

³The Senate Amendment is the same as the House Bill, except that the increase in the credit rate to 14 percent begins on or after January 1, 1987 and the income phase-out range is raised to \$10,000/\$17,000 beginning on or after January 1, 1988.

⁴The Conference agreement follows the Senate amendment, except that (1) the base against which the increased 14 percent credit applies is raised to \$5,714, (2) the income phase out levels are raised to \$9,000/\$17,000.

V. CONCEPTS AND METHODOLOGY

Definition of Terms

To the average citizen, the terms "income" and "taxes" may seem self-explanatory. Income is the sum of the earnings he receives for services and the return on the investment of capital. These are also the definitions that the economist would apply in the case of most individuals. However, they ignore many complications that arise from the intricacies of a modern economy and of the government's relationship to the taxpayer.

Taxable Income

In Sec. 63 of the Tax Reform Act of 1986, taxable income means gross income minus the deductions allowed by the law (other than the standard deduction).

Personal Deductions

Personal deductions are expenses that are subtracted from Adjusted Gross Income (AGI) in arriving at taxable income. They cover living expenses and certain cost of obtaining income which are subtracted from gross receipts in computing AGI. The major items are interest paid, medical expenses, philanthropic contributions, and taxes paid. Minor items include uninsured casualty losses, child-care expenses and miscellaneous deductions. Taxpayers may elect a limited standard deduction in lieu of itemized personal deductions.

Exclusion from Taxable Income

These are items that are excluded from taxable income after personal

deductions. These are gifts and inheritances, selected government transfer payments like public assistance, veterans' benefits and unemployment insurance. Others are, social security and railroad retirement, workmen's compensation health insurance, and sick pay etc.

Rates and Personal Exemptions

Personal exemptions have four major functions:

- 1) keeping the total number of returns within manageable proportions particularly holding down the number with tax liability lower than the cost of collection;
- 2) freeing from tax the income needed to maintain a minimum standard of living;
- 3) helping to achieve a smooth graduation of effective tax rates at the lower end of the scale, and
- 4) differentiating tax liability according to family size.

Effective Rate

This is tax paid divided by the relevant affluence measure, usually income.

Progressive Rate Structure

A tax rate structure is progressive if effective rates are higher in high-income groups than low-income groups.

Regressive Rate Structure

A tax structure is regressive if effective rates are lower in the high-income groups than in low-income groups.

Methodology

The writer used descriptive analysis to examine the probable impact of the Tax Reform Act of 1986 on the Black population. Secondary data collection techniques were utilized to obtain relevant information for this study. Some of the data used were also collected from newspapers, journals, unpublished papers, and

the Bureau of the Census.

The discussion in the next section would be based primarily on various opinions and assumptions raised by economists and the general public on the probable impact of the new tax law.

Scope and Limitations

Since the study did not attempt to utilize and quantify data to analyze the probable impact of the new law on Blacks, the assumptions and recommendation should not be used entirely for evaluation of the new income tax. They should be used as a base to conduct more indepth research on the tax system of the United States.

VI. DISCUSSION OF PROBABLE IMPACT

Economic Status of the Black Population

Income is probably the most useful single measure of economic position. It has, therefore, been chosen to focus the discussion primarily on an analysis of trends in the levels and sources of Black income to show the impact of the tax law on Blacks. Obviously, income determines how well one eats, dresses, and is housed. It also determines where one lives and goes to school. It determines one's ability to raise a family, the type and quality of education that one can provide one's children, and many other things.

Higher incomes, in general, provide the potential for taking care of more human needs. Low incomes generally signify deprivation and difficulties. Rising incomes mean improving living standards while falling incomes mean increasing deprivation. Labor income accounts for over 80 percent of Black income and as will be noted later, only about 20 percent of Blacks receive property income which is usually deductible to some extent and this account for most of the overall income inequality while. However, about 75 percent of White incomes come from employment and 60 percent of Whites receive property income.

The median income of Black families in 1980 was \$12,674. This means that on the average, half of Black families received more than this amount and half received less. During 1980, about 29 percent of Black families and 31 percent of the persons living in Black households were below the poverty level. On the other hand, the median income for White families was \$21,904. Thus, Black families received about \$58 dollars in income for every \$100 dollars received by Whites. White families were also much less likely to have incomes which placed them below

the poverty level, with only 8.6 percent of persons in White families below the poverty level in 1980.³³ This shows why Blacks are more likely to feel the burdens of a tax system that increases the tax rates for low-income groups. According to census income reports, more than 20 percent of Blacks were recorded as having received property income while about 60 percent of Whites receive property income.

Another significant status of the Black population is the ever increasing rate of the single female head of Household. It has been noted that a majority of the Black (female) population falls in this category.³⁴ This factor also indicates the reason why Black females in that category would bear more of the tax burden than White females.

Probable Impact

Using income as a tax base is probably one reason why the income tax is rather unfair to Blacks. This is because, as was noted earlier, a greater portion of Black income proportionally comes from employment. Income is probably an incomplete measure of the quantity of resources at the disposal of a person, since it does not take account of wealth (for example, property aquisition), which also represents command over resources. Joseph Pechman and Ben Okner, indicated that:

The structural features of the tax system affect different types of income and spending differently. As a consequence, relative tax burdens depend not only on the amount of income and the way in which it is spent. They also depend on whether a family owns assests or borrows money and in particular, whether it owns a

³³U.S. Department of Commerce, Bureau of the Census, Current Population Reports Series P-60, No. 133. Table 1 (Washington, D.C.: U.S. Government Printing Office, 1982).

³⁴Scholz, "The Racial Implications of the 1981 Tax Act," p. 1.

house that is mortgaged. All of these factors work to produce very different relative tax burdens - even among families with³⁵ the same income - whatever the true incidence of taxation may be.

The deductions and credits allowed in the income tax system are quite proper. This is a break for both the Black and White population. The primary justification for a broad definition of the tax base is that taxpaying capacity can be better measured by total net income than by the sum of certain components. Since the omitted items are not evenly distributed, some people gain while others lose.

The increase in the standard deduction is good news to the public and especially to Blacks. The standard deduction is supposed to lessen the extent to which income tax liability depends on expenditures for deductible items. It is difficult to distinguish between desirable and undesirable deductions.

The increase in the standard deduction for family status is probably better most especially on the single female head of household. The increase in deduction allowed for head of household is proportionally higher than that of the married couples in the old law. The old law allowed \$2,600 for head of household while married couples were allowed \$3,850. The new law now allows \$4,400 for head of household while the joint return (married couples) are allowed \$5,000. The share of the burden on the head of household is decreased in the new law because of the increase in the standard deduction for single head of household. This particular relief is most welcomed to the Black population because proportionally, a majority of the people in that category are Black females.

Table 3 shows the comparison of the federal income tax of the head of household and that of married couples for 1988. The table also shows the

³⁵ Joseph A. Pechman and Benjamin A. Okner, Who Bears the Tax Burden? (Washington, D.C.: The Brookings Institution, 1974), p. 66.

TABLE 3

FEDERAL INCOME TAX OF HEAD OF HOUSEHOLD PERSONS
COMPARED WITH THAT OF MARRIED COUPLES,
BY GROSS INCOME, 1988 AND LATER^a
(Amount in Dollars)

Tax Liability			Difference	
Income	Head of Household	Married Couples	Amount	As % of Married Couples Tax
5,000	750	750	0	0
15,000	2,250	2,250	0	0
25,000	4,679.5	3,750.0	929.5	24.8
35,000	7,479.5	5,932.5	1,547	26.0
45,000	10,279.5	8,732.5	1,547	18.0
65,000	15,879.5	14,332.5	1,547	11.0
85,000	21,479.5	19,932.5	1,547	8.0
150,000	36,689.5	38,132.5	1,547	4.0
200,000	53,679.5	52,132.5	1,547	3.0

Source: Calculated from Statutory Tax Rates (15 percent and 28 percent, incomes up to \$17,850 and \$29,750 respectively).

^aAssumes that income is still gross, married couples file joint returns, the maximum rate is 28 percent.

percentage difference in tax liability of head of household to married couples as it declines when their income increases. For example, when income is \$25,000, the percentage difference of head of household from that of married couples is 24.8 percent, however, when the income is \$85,000, the percentage difference is only 8.0 percent. These comparisons do not account for the various credits, that is, the personal exemption and standard deductions.

The personal deductions have been increasingly questioned. When taxes were raised some decades ago, suggestions were made for curtailing personal deductions. The adoption of the predecessor of the standard deduction in 1941 seems to have been motivated partly by doubts about the desirability of itemized deductions. More recently, many critics have come to regard personal deductions as cause of the erosion of the tax base and have suggested that they be restricted.

Some of the deductions like interest paid, political contributions and local sales taxes have been eliminated while others like deductions for medical expenses, child-care, are still allowed because these deductions are intended to relieve hardship.

The elimination of interest expenses (especially on credit cards) and local sales tax deductions may have very little effect on the Black population. As it was pointed out earlier, proportionally, more Blacks are in the low-income groups than Whites, this will probably make them less qualified for credit initially, than Whites. Moreover, with the former provision that allowed deductions for interest expenses, it was like giving back more to those who already have. This new provision will probably bring a degree of fairness into the new tax law. On the other hand, the increase in the threshold for medical expenses from 5 percent to 7.5 percent of AGI may reduce the number of Blacks that would qualify for deductions for

medical expenses. This may be due to the fact that a majority of the Black population falls within the low and middle income group. This group probably spends less than 7.5 percent of its AGI on medical expenses, thereby finding it difficult to meet the 7.5 percent threshold. Therefore, most Blacks and others in this group, would probably have to bear the medical expenses alone while others in the high income group get relief from the government. This is another indication of unfairness to the Black population and the low and middle income group in general.

Relative to income, the personal deductions are greatest in the lowest and highest income classes, dipping somewhat in the intermediate range. The high ratio to income in the lowest income classes is due entirely to the standard deductions and particularly to the low-income allowance which is the predominant form of the standard deduction in AGI classes below \$5,000.³⁶ The standard deduction no doubt greatly facilitated the extension of the income tax during World War II to millions of persons who had not previously filed returns. This significant curtailment of itemized deductions would make appropriate a cut in the percentage of standard deductoin. These revisions would allow a reduction in tax rates without loss of revenue and would bring about a reapportionment of taxes among individuals.³⁷

Interest costs for home mortgages are fully deductible for up to two homes. This provision is favorable mostly to high income earners that can afford two homes. It is no good news for Black taxpayers since most of them are in the low

³⁶U.S. Internal Revenue Service; Statistics of Income - 1970, Individual Income Tax Ratio (Washington, D.C.: U.S. Government Printing Office, 1970), p. 103.

³⁷Ibid., pp. 108 and 131.

and middle income bracket.

The new tax law also repeals the 60 percent exclusion for capital gains income for individuals, thus taxing capital gains as ordinary income. This probably does not affect the majority of the Black population since it is assumed that very few of them are recipients of capital gains. The progressivity and equity of the tax are greatly affected because of the concentration of capital gains in the hands of high-income groups.

Owing to the distribution of capital gains, the preferential tax rates for high-income groups have little effect on average effective tax rates in the lower brackets but substantially reduce average effective rates at the top, thereby lessening progressivity. Therefore, the elimination of deduction of capital gains from income is another attempt at redistributing the tax burden. Full taxation of capital gains, with proration or averaging, would increase the yield and progressivity of the income tax.³⁸ This is another indication of fairness to Blacks and other low and middle income groups in the new tax law.

The tax law continues the indexation for inflation of the tax brackets, standard deduction, and personal exemption. The debate about the desirability of indexing the income tax for inflation touches on a number of unsettled questions but it is assumed to be technically provided to bring fairness to the system and also to the Black population.

With personal exemptions, bracket limits, and certain deductions fixed in money terms and with graduated rates, the average effective rate of income tax rises during inflation. The relative increase (that is, the elasticity, defined as the percentage increase in tax divided by the percentage increase in income) will be

³⁸Goode, The Individual Income Tax, p. 187.

greatest for taxpayers whose income is near the exemption limits; under most rate schedules the relative increase will taper off fairly rapidly over higher income ranges. In an inflationary period, moreover, the irritation that consumers feel (including Blacks) because their incomes do not go as far as expected may come to be directed to a disproportionate degree against direct taxes, which are recognized as under government control.

VII. CONCLUSION AND RECOMMENDATION

In appraising the income tax or any other tax, it is well to recognize that the desirable features are to some extent competing. Equity and progressivity have a cost in complexity and administrative difficulty and also may have an economic cost. While it is the writer's judgment that these conflicts are less acute than has often been implied, as long as no one objective is pursued to extreme lengths, their existence would not be denied.

The impact of the overall tax system on the tax burdens of the Black population depends on the extent to which the system stresses progressive versus regressive taxes. Since it has been noted that the Black distribution of income is skewed towards lower income classes, Blacks are harmed by shifts of the tax system to more regressive forms of taxation. Similarly, since Blacks receive higher shares of employment and employment related income than other groups, tax changes which favor property income over employment income would also shift the burden more towards Blacks. Likewise shifts from corporate sources to individual sources would disadvantage Blacks for similar reasons. Any law that also increases the proportion of the difference in tax liability of single head of household to that of married couples would probably put more burden on Blacks in that category.

It is therefore recommended that policy makers should put more emphasis on the afore-mentioned factors to ensure an even distribution of the tax burden. Blacks should also try to seek income from other sources (for example, property acquisitions, business investments) to relieve themselves of some of these tax burdens. This could probably be achieved if the requirements to get access to

these sources of income are reduced so as to enable more people (especially the people in the low-income groups) to get access to these sources. They should also educate their young ones to see the merits of family life so as to stop the increase in the female headed households. It would be over-optimistic to expect a sweeping reform that would resolve all outstanding issues at once. But gradually, with patience and energy in the study of taxation, in the dissemination of research results, and in persuasion, income tax reforms can be achieved and a good tax made better.

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